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STATE FOR PM/DTCC - BLUE LANTERN COORDINATOR
STATE FOR NEA/IPA (MAHER)

E.O. 12958: N/A

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SUBJECT: REPORT ON BLUE LANTERN LEVEL 3 END-USE CHECK ON
LICENSE DA-1643-00

REF: 2006 STATE 130060

¶1. (SBU) On November 15, 2006, Blue Lantern Officer and Defense Contract Management Agency (DCMA) employee conducted a site visit to the former Israel Military Industries Aircraft System Division (IMIASD) facility and met with Danny Inbal, Corporate Security Director; Israel Zigerson, Purchasing Manager; Avi Goldberg, Purchasing Control Manager; Ruth Lipkin, Deputy Legal Advisor at IMI; and Yaron Arad, Deputy Security Director for Information Security. Inbal, who acknowledged upon questioning that he is an employee of MALMAB/DSDE -- the Israeli MOD's security division -- led the Israeli team during discussions that lasted over two hours, and the tour of the facilities that followed.

¶1A. In response to the Blue Lantern Officer's question, Inbal confirmed that the facility is operating under authority granted in DA-1643-00. Inbal and his team provided the following information during the visit:

¶1B. Description of IMIASD and the Tirat Hacarmel facility: IMIASD is no longer a part of IMI. It used to manufacture and assemble parts for weapons pylons and fuel tanks for the F-15 and F-16. IMIASD had 4,000 employees at the height of its operations. Its aviation in Tirat Hacarmel plant was sold to Cyclone.

¶1C. Description of Security at the IMIASD facility: As a result of the loss of the 24 controlled items, IMI has revised its security procedures and thoroughly reviewed the briefing that it gives its employees. Inbal noted that the Israeli Security Agency (a.k.a. the Shin Bet -- the equivalent of the U.S. FBI) conducts a background check on every employee and subcontractor. Visitors to the facility are escorted. The facility's perimeter is monitored by an alarm system, and there is a control room at the main gate. Spot checks are conducted on vehicles entering and exiting the facility. All of the facility's security personnel are trained in counterterrorism and receive periodic refresher training from MALMAB/DSDE. WDA and DSP-5 parts are stored separately.

¶1D. Question: What articles licensed under DA-1643-00 (or any other Department license) were transferred to Cyclone?

Answer: According to Inbal and his team, none under the WDA. Under the DSP-5, all items needed to assemble pylons. Inbal said that Cyclone knows that it cannot own parts until the re-transfer is authorized. Until then, Cyclone can only operate as a subcontractor for IMI. To date, Cyclone only assembles parts as a subcontractor to IMI. Inbal claims that no WDA parts were ever passed into the hands of Cyclone, and that no controlled items part have been transferred to Cyclone for assembly under the WDA. Inbal said that some

DSP-5 parts and production line equipment were provided to Cyclone in its capacity as a subcontractor. Inbal said that no WDA items have been sold to Cyclone.

IE. Question: Have any other licensed operations/articles been transferred from IMI, Israel to Cyclone?

Answer: No. Ownership of items subject to licenses has not been transferred.

IF. Question: What were the provisions of the asset transfer agreement between IMI, Israel and Cyclone?

Answer: IMI and Cyclone's legal understanding is that the supply of parts to Cyclone in its position as subcontractor is not re-transfer. IMI sells and receives payments for finished products. IMI is seeking the re-transfer of its license to Cyclone. According to Inbal, a request for approval was sent to Susan Clark in DTC Licensing. IMI and Cyclone are now following the "Luks plan" named after a former employee of PM/DDTC, Harold Luks, who now also works for Elbit. IMI's legal department is consulting with Luks and a U.S. lawyer on these steps. On December 31, 2003, a conditional agreement with Cyclone was signed, wherein certain conditions had to be fulfilled by dates certain to affect the transfer. The agreement has not been completely fulfilled. On March 20, 2005, Cyclone and IMIASD signed a second amendment to this conditional agreement. This amendment noted adjustments to the original agreement, and the intent of the parties to conclude a re-transfer agreement. The agreement is to be executed by Cyclone's subsidiary, MATLAM Mechanics Karmiel, Limited. Article 5 of the agreement identifies the various actions that have to be carried out. In Chapter 6, it refers to the fulfillment of State Department licenses and permits according to the Luks

plan. Annex B specifies all the required activities. This annex was attached to the closing documents. It was signed on March 27, 2005.

IG. Question: Does IMI, Israel continue to operate the warehouse in Tirat Hacarmel, Haifa?

Answer: Yes.

IH. Question: Has IMI, Israel continued to investigate the missing articles listed in its disclosure?

Answer: Inbal said that while the investigation has been closed, awareness regarding the importance of protecting controlled items among employees has increased, and procedures have been revised to minimize or prevent future losses. Inbal noted that there are 350 pieces in a pylon. Only 24 parts for pylons went missing. No parts for fuel tanks disappeared. The 24 parts consist of 4 types of parts, including fuel system parts. Inbal gave emboffs a list of the missing parts with their part numbers. Inbal said that the disappearance of the parts was reported in voluntary disclosures sent to the State Department's Office of Defense Trade Controls Licensing; and Office of Defense Trade Controls Compliance. IMI's president signed the disclosures. Inbal said that there were 950 parts that were supposed to be in the WDA warehouse when, during an inventory in October 2005, IMI discovered that 24 of the parts were missing. Inbal clarified that the closing of the division is what prompted the inventory. Upon discovery that parts were missing, a fact-finding team was set up to locate the missing parts. The team did not find the parts, but concluded that the parts were not re-transferred or sold. (NOTE: While touring the facility, Inbal told Blue Lantern Officer he believes that the parts might have been damaged in assembly training exercises, and thrown out by employees who did not understand that you cannot simply throw away such items.)

II. Question: Has IMI, Israel informed IMITRADING, U.S. of the missing articles?

Answer: Inbal answered affirmatively, but said that he cannot find the specific document proving this. He claimed that all questions posed by DDTC were also addressed to IMITRADING, U.S.

¶2. (SBU) On November 21, Blue Lantern Officer and DCMA Employee made a site visit to Cyclone's facilities in Karmiel and met with Eitan Igira, Cyclone's Vice President for Programs and Sales; Adar Dotan, Head of Security at Cyclone; and Milstein Marcel, Cyclone's Warehouse Manager. Igira said that he has overseen the movement of IMI programs to Cyclone. Igira and his team provided the following information during the visit:

¶A. Description of Cyclone: Cyclone is a subsidiary of Elbit Systems Group, the largest private defense company in Israel. It is owned 100 percent by Elbit. It reports to the Airborne and Helmet Systems. Cyclone has been owned by Elbit since 1999. Previously, it was a public company. Ninety-five percent of Cyclone's operations are in Karmiel, where its headquarters is located. It has 50 persons at an Israeli Air Force (IAF) base in the south. Among other things, it produces the access door for the Boeing 747. It subcontracts to Vought in the U.S.

Seventy-five percent of Cyclone's operations concern design and production. Cyclone conducts overhauls and repairs on IAF helicopters and aircraft. It performs this service for local and outside customers. Cyclone designs and produces fuel tanks and pylons that it is acquiring from IMI. Cyclone also manufactures the Elbit Group's Unmanned Aerial Vehicles (UAVs), including the Hermes 450 and 1500. Cyclone works as a subcontractor on helicopters for many Israeli primes. Lockheed and SIBAT have representatives located at Cyclone's facilities in Karmiel. They conduct quality control audits all the time.

Boeing's military side has been Cyclone's main customer since ¶1978. Next in line are General Dynamics/Lockheed Martin, with the F-16. Cyclone also supplies spare parts to the U.S. Air Force -- its third largest customer. Cyclone produces many parts for the F-16 including the 600 gallon fuel tank and pylons. The pylons and fuel tanks are brought to Cyclone from IMI. They are not in production yet, because there are no orders or customers at this time. Cyclone is a single source producer for the Lockheed Martin production line. It also produces the centerline pylon, which was formerly done at IMI Haifa.

Most of its sales are to military customers. Next year (2007), its commercial side will expand due to anticipated work on the Boeing 757. In the past, it produced 330 gallon external fuel tanks for the F/A-18 Block C/D. It bought from IMI the rights to produce the F-15 fuel tanks and pylons.

Cyclone is also working on the fan cowl doors for the Russian Regional Jet (RRJ) program in Russia. Cyclone added Far Eastern air forces and NATO air forces as its customers due to its purchase of IMIASD

Cyclone performed work on the MD-11 engine. It is a sole source provider of the MD-11's doors and pylons. It also produces elevators for the Airbus 310, the tail skid fairing for the Boeing 767, the nose landing gear doors for the Boeing 787, and the wheel well doors for the Boeing 737.

¶B. Description of Security at Cyclone: Cyclone works of a system called the BAAN System. Controlled items are managed by a computer system. Procurement, inventory and production are all monitored on the computer system. It is a closed system. Items can be traced by purchase order, license number, received items, inventory management. Parts are also tied to programs. Only the security manager can override this aspect. A security officer signs on all applications.

Cyclone is implementing a new labeling process to replace the existing one. The new labels include more data on them.

Elmec in the U.S. asks for licenses for Elbit Group. Also controls shipment to Israel. Purchase orders from Cyclone go to Elmec.

Security features at the warehouse include physical ones (e.g., fence surrounding complex, alarm systems). No controlled items have ever gone missing.

IC. Question: What were the details of the acquisition of IMIASD by Cyclone?

Answer: Cyclone bought some of IMIASD's parts, but not all of the parts in IMIASD's warehouses containing controlled items. These include the WDA agreement parts and parts subject to DSP-5 licenses. Uncontrolled parts have been physically transferred to Cyclone. Cyclone is not actively working with controlled items subject to the WDA agreement. They remain at the IMIASD facility in a separate warehouse. In theory, Cyclone has bought this warehouse from IMIASD. Igra said that Cyclone has not started any kind of physical re-transfer of the parts, and IMI continues to manage the warehouse. Igra corroborated what the IMIASD team stated: that there has been no activity at the WDA warehouse for some time as there are no orders from customers. Cyclone started the process to re-transfer licenses for the DSP-5 parts. Igra confirmed that IMI had submitted the request for re-transfer, and that it has not yet been approved. Igra stressed that all controlled inventory remains in the warehouse managed by IMIASD, and that Cyclone -- in effect -- owns a "virtual warehouse."

ID. Question: Has Cyclone distributed U.S. defense articles obtained from the acquisition of IMIASD? If so, to what parties were sales/transfers made?

Answer: No. All sales and/or transfers were made under IMI. Cyclone does not sell parts as they are controlled items, and purchase orders are directed to IMI, for which Cyclone performs subcontract work. Cyclone merely finishes assembly. IMI then sells the parts, receives payment for the parts, and then transfers the payment to Cyclone. When Cyclone assembles anything, it is sold through IMI.

IE. Question: Does Cyclone understand the restrictions on USML articles, particularly regarding re-exporting (i.e. no re-export without USG authorization)?

Answer: Yes.

IF. Question: Has Cyclone continued W&AD operations under the authority of DA-1643-00? If so, what articles have been procured by Cyclone, and from what sources? Where are licensed articles warehoused by Cyclone? What security and inventory procedures are in place for these articles?

IG. Answer: No. IMI is still managing Cyclone's warehouse. There is some thought about canceling the agreement.

IH. Question: Has Cyclone conducted investigations into the whereabouts of the 24 missing items listed in IMI, Israel's disclosure? If so, has it discovered pertinent information?

II. Answer: IMI informed Cyclone that the parts were missing. IMI searched Cyclone's facilities and did not find anything. Cyclone cooperated with the investigation into the missing parts. No pertinent information was discovered.

I3. (SBU) IMIASD provided the following documents to emboffs. They have been FAXed to Compliance Specialist Michael Romero at PM/DTCC, FAX number: 202-261-8198:

IA. March 30, 2006 letter to David Trimble, Director, PM/DTCC, concerning voluntary disclosure of 24 missing controlled items (1 page).

IB. June 27, 2006 letter to Susan Clark, Acting Director, Office of Defense Trade Controls, Licensing, requesting

approval for re-transfer; and attachments (53 pages).

IC. August 16, 2006 letter to Haim Guz, President of IMITRADING, U.S., from Patricia Slygh, Chief, Enforcement Division (2 pages).

ID. September 14, 2006 letter to Jae Shin, a compliance specialist in PM/DDTC, regarding the above-mentioned letter from Slygh to IMITRADING, U.S. (4 pages).

IE. October 18, 2006 e-mail from Harold Luks to Eitan Igra re: updating on the re-transfer request (3 pages).

IF. November 13, 2006 letter to Jae Shin of PM/DDTC and Blue Lantern Officer Michael Keays re: responses to questions posed to IMIASD (2 pages).

IG. November 13, 2006 letter to Haim Guz, President, IMITRADING, U.S., from Avraham Goldberg, IMIASD Sales Manager (4 pages).

IH. Power Point Presentation on Cyclone Aviation Products, Ltd. (26 pages).

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JONES